No. 10214.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

TODD W. JOHNSON,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF FOR THE APPELLANT.

TODD W. JOHNSON,
742 Title Insurance Building, Los Angeles.
In Propria Persona.

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BRIEF FOR THE APPELLANT.

---

1. Jurisdiction.

This appeal involves income tax and is taken from a judgment of the District Court of the United States for the Southern District of California. Central Division, entered June 30, 1942. [R. 66, 67.] The opinion, special findings of fact and conclusions of law may be found in the record [pp. 43-65]. Notice of appeal was filed July 13, 1942. [R. 67-68.] The jurisdiction of this Court is invoked by virtue of the provisions of Section 128(a) of the Judicial Code, as amended by the Act of February 13, 1925.

2. Questions Presented.

1. Does appellant's wife, who owned half of certain accounts receivable, consisting of legal fees earned but not collected and on which no income tax has been paid, escape payment of the income tax thereon, by transferring her half of said fees to appellant in a property settlement and receiving in lieu thereof a one-half interest in other property, which interest has a market value equal to the face value of said half of said accounts receivable?

2. Is appellant taxable on the entire amount collected by him from the half of said legal fees acquired from his wife in a property settlement by transferring his half of other property to her, or is he entitled to recover the cost of his half of the property transferred to his wife before realizing any taxable income?

3. Statutes Involved.

Revenue Act of 1934:

"Sec. 22. Gross Income.

(a) General Definition.—*Gross income includes gains, profits and income derived from* salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, or *sales or dealings in property*, whether real or personal, *growing out of the ownership or use of or interest in such property;* also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, *or gains or profits and income derived from any source whatever.* * * *

* * * * * * * * *

(e) Determination of Gain or Loss.—In the case of a sale or *other disposition of property,* the gain or loss shall be computed as provided in section 111.

* * * * * * * * *

Sec. 111. Determination of Amount, and Recognition of, Gain or Loss.

(a) Computation of Gain or Loss.—The gain from the sale or *other disposition of property* shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) Amount Realized.—The amount realized from the sale or *other disposition of property* shall be the sum of any moneys received plus the fair market value of the property (other than money) received.

Sec. 112. Recognition of Gain or Loss.

(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges Solely in Kind.—

(1) Property Held for Productive Use or Investment.—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

* * * * * * * * *

(c) Gain From Exchanges Not Solely in Kind.—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

* * * * * * * * *

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that— * * *

(6) Tax-Free Exchanges Generally.—If the property was acquired, after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112(b) to be received, without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent

to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

* * * * * * * * *"

(Italics supplied by appellant.)

4. Statement of Facts.

At all times involved herein appellant and his wife were residents of California. [R. 51, 77, 78.] They were married in 1921. [R. 51.] From 1925 to January 1, 1935, when they separated permanently, they lived together as husband and wife. [R. 51.] On March 4, 1935, they made a written property settlement [R. 12 to 19, inclusive], dividing equally between them all of their joint and community property. [R. 52.] Each spouse received all of certain properties instead of an undivided half of each item of property. [R. 52.] All of the properties owned by them on March 4, 1935, consisting of both community and joint tenancy property, were acquired after July 29, 1927, and were traceable to legal services performed by appellant as a member of the marital community. [R. 51, 52.] On April 1, 1935, Mrs. Johnson obtained an interlocutory, and on April 2, 1936, a final divorce decree. [R. 52, 53.] Appellant discharged his liability, if any, for the support of or alimony to his wife, by agreeing to pay and later paying her $500.00 per month for one year. [R. 53.]

The fair market value of all the community and joint property on March 4, 1935, was $172,379.41. [R. 55.] This total of $172,379.41 included accounts receivable of the face and market value of $52,028.45, representing legal fees earned but not collected. [R. 55.]

The total cost of all of said community and joint property was $135,430.35. [R. 56.] Said fee accounts receivable had no cost to the two spouses. [R. 56.] Total depreciation had been sustained and allowed in the income tax returns of the two spouses in the sum of $3,590.84. [R. 56.] Each spouse owed income tax of $5,082.78 for the year 1934 and $3,118.95 for the year 1935 on the basis of their returns as filed. [R. 56, 57.]

The cost to each spouse of his or her one-half interest on March 4, 1935, in each particular property owned by the two spouses jointly was exactly one-half of the total cost to the community or to the two spouses of said particular property. [R. 57.]

In the property settlement transaction appellant acquired his wife's half of property having a total market value of $49,189.71, computed as follows: $26,014.23 for her half of $52,028.45 of fee accounts receivable and $23,175.48 for her half of other community and joint property. [R. 58.]

In said transaction appellant transferred or gave up to his wife his half of joint and community property which had a cost to him of $38,610.41, on which amount he had already paid an income tax, and he also assumed and paid her 1934 and 1935 income taxes totaling $8,201.73, making a total of $46,812.14 given up to or paid for her by him. [R. 59.]

Appellant's wife thereby acquired appellant's half, having a market value of $37,000.00, of certain joint and community property and also had her 1934 and 1935 income taxes in the amount of $8,201.73 assumed and paid by appellant, making a total of $45,201.73 acquired by her in the property settlement. [R. 59.]

She transferred or gave up to appellant her half of certain accounts receivable on which she had no cost, and also her half of certain other joint and community property which had cost her $27,309.53. [R. 59.] She had already paid an income tax on this $27,309.53. [R. 59, 60.]

Appellant included as income one-half of the collections of said fee accounts receivable of $52,028.45 or $26,014.22, in his 1935 income tax return and his wife included the other half thereof in her return as her income. [R. 80, 81, 82, 83.] Both spouses filed all of their income tax returns, including the ones for 1935, upon the cash basis. [R. 79.] The Commissioner of Internal Revenue determined that appellant was taxable on the entire $52,028.45 collected by him from said accounts and that his wife was taxable on no part thereof. [R. 80, 81, 82, 83.] The lower court affirmed the Commissioner's determination. [R. 46, 47.]

5. Specification of Errors to Be Urged.

1. The District Court erred in holding that appellant received taxable income of $52,028.45, instead of $26,-014.23, when he collected certain accounts receivable representing legal fees earned but not collected, because he owned all instead of half of said accounts at the time they were collected, notwithstanding the fact that he only owned a community half therein when said fees were earned and despite the fact that he acquired his wife's community half thereof in a property settlement whereby he gave up or conveyed to her his half of other joint and community property having a cost and value equal to the face and market value of said accounts.

2. The District Court erred in failing to hold as a matter of law that because appellant's wife owned half of said fees at the time they were earned, she was taxable on half thereof when said fees were collected by appellant.

3. The District Court erred in failing to hold that the transfer to appellant by his wife of her community half of said accounts receivable, representing legal fees already earned but not collected, in return for appellant's half of other community and joint property and his payment of her 1934 and 1935 income taxes, was a taxable event or final event of enjoyment whereby she realized income or gain on a cash basis to the full extent of her half of said fees.

4. The District Court erred in failing to hold that appellant's wife realized gain or loss in the property settlement, computed or based upon the difference between the cost of her half of certain joint and community property, which she transferred to appellant, and the market value of appellant's half of certain other joint and community property which he transferred to her.

5. The District Court erred in failing to hold that appellant realized gain or loss in the property settlement only upon the difference between the cost of his half of certain joint and community property which he transferred to his wife (plus certain of her income taxes assumed and paid by him) and the market value of her half of said accounts receivable and other joint and community property which she transferred to him.

6. The District Court erred in failing to hold that said property settlement was a sale, exchange or disposition of, or dealing in, property whereby gain or loss was realized by each spouse, based upon the difference between his or

her cost of the one-half interest conveyed to, and the market value of the one-half interest received from, the other spouse, with proper adjustment for income tax of his wife assumed and paid by appellant.

7. In the alternative, even if the property settlement was a tax free exchange, disposition of or dealing in fractional interests in property, on which no gain or loss was recognized to either spouse, the District Court erred in failing to hold that before appellant realized any taxable income when he subsequently disposed of the half of said fees acquired from his wife by collecting the sum of $26,014.23, he was entitled to recover the sum total of his cost of his half of certain other joint and community property which he gave up or transferred to her and her 1934 and 1935 income taxes paid by him for her.

8. The District Court erred in failing to hold that, regardless of whether the property settlement was a transaction whereby gain or loss was or was not recognized to each or either of the spouses, appellant was entitled to recover his cost of his half of the joint and community property which he transferred to his wife, and the income taxes paid by him for her, before he realized any taxable income from his subsequent disposition by collection of the half of said accounts acquired from her.

6. Summary of Argument.

In the property settlement transaction appellant transferred or surrendered to his wife his half of property with a cost of $38,610.41, on which he had already paid income tax, and assumed and paid her income tax of $8,201.73, or a total of $46,812.14. He acquired from his wife her half of other property, with a market value of $49,189.71,

which total includes her half of said fee accounts receivable at face value of $26,014.23.

At no time could he possibly have income of more than $2,377.57, being the difference between $49,189.71 and $46,812.14, regardless of whether the property settlement was a transaction whereby gain or loss is recognized to the two spouses.

If gain is recognized at the time of the property settlement appellant had taxable income of $2,377.57 but he had no further gain when he collected his wife's half of the accounts receivable, because their full fair market value is taken into account in computing the gain of $2,377.57.

If no gain or loss is "recognized" at the time of the property settlement the gain "realized" is still the same as if "recognized," but the reporting of such gain for income tax purposes is deferred until the property acquired by each spouse from the other is disposed of. Thus in 1935 when appellant disposed of part of the property he acquired from his wife, viz., her half of the fee accounts receivable, $1,257.39 of the realized gain of $2,377.57 would be "recognized" computed as follows: $\frac{\$26,014.23}{\$49,189.71}$ x $2,377.57=$1,257.39. The balance of the "realized gain" would not be "recognized" until he disposes of the other property acquired from his wife.

Appellant's wife transferred or surrendered to appellant her half of property with a cost of $27,309.53, on which she had already paid income tax and her half of the fee accounts receivable on which she had no cost and had paid no income tax. She acquired from appellant his half of property having a market value of $37,000.00 and had her income taxes of $8,201.73 paid, thereby receiving a

total of $45,201.73. She therefore actually "realized" a gain of $17,892.20, being the difference between $45,-201.73 and $27,309.53, regardless of whether such gain is then "recognized" for income tax purposes, or deferred until she disposes of the property acquired from appellant.

If gain is "recognized" when the property settlement was made she had taxable income of $17,892.20 in 1935. If the gain is not then "recognized," she nevertheless "realized" the same gain of $17,892.20, but such gain is not "recognized" for income tax purposes until she disposes of the property acquired from appellant.

When a taxpayer once owns accrued or earned income he or she must pay the income tax thereon and cannot by transferring it to someone else escape paying the income tax thereon. On the accrual basis of accounting the owner of income is taxable the minute the income accrues or is earned, regardless of whether said owner afterwards transfers it to someone else or not. On the cash basis the owner does not pay income tax on the income until it is collected or until he or she transfers it for a valuable consideration, but once he or she owns the income he or she must pay income tax on it when it is realized by a "taxable event" which is generally the collection thereof. When the owner of accrued or earned income disposes of it by gift he or she is taxable thereon when the transferee collects it, but when he or she disposes of such income for a valuable consideration in money or money's worth a "taxable event" occurs and he or she is taxable immediately on the consideration received.

Appellant's wife received exactly the same economic benefit by transferring or surrendering her half of said fee accounts receivable to appellant as if she had collected her half and then purchased with the proceeds thereof

appellant's half of the property which she acquired from him. Having received such economic benefit she is taxable on her half of said fees.

Ownership at the time income accrues or is earned determines the person who is taxable thereon and the ownership at the time the income is collected is immaterial —*Horst* and *Eubank* cases, *infra.* The lower court held that ownership at the time of collection determines the person taxable on such income and therefore such decision should be reversed.

7. Argument.

At the outset appellant wishes to emphasize that only the taxability of his wife's one-half of the accounts receivable, representing fees earned but not collected, is involved herein. In his 1935 income tax return appellant reported and paid a tax on income of $26,014.23, representing his half of said accounts receivable of $52,028.45. [R. 80, 81, 82, 83.] It is only the $26,014.23 collected by him from the one-half interest in said accounts acquired from his wife in the property settlement which is involved in this case. [R. 53.]

Appellant's payment of monthly alimony for one year to his wife does not affect this case and will not be commented upon unless mentioned in appellee's brief, in which event the matter will be discussed in appellant's reply brief.

Also appellant wishes to emphasize that this case involves income earn *before* but collected by appellant *after*

the property settlement agreement—or, in other words, *past earnings.*

The courts, with little if any conflict, have held that the transfer or assignment of *future earnings or income* does not relieve the assignor from income tax thereon. However, until the United States Supreme Court decided the *Horst* and *Eubank* cases, *infra,* there was a violent disagreement in the lower courts as to whether the transfer or assignment of income already accrued or earned relieved the assignor from income tax thereon. For instance in the *Eubank* case, *infra,* the United States Circuit Court of Appeals held the assignee taxable on assigned income already earned or accrued, while in the *Van Meter* case, *infra,* a different United States Circuit Court held the assignor taxable thereon. The correct law on this point was settled in the *Eubank* and *Horst* cases, *infra,* when the United States Supreme Court held that the assignor and not the assignee was taxable on income which was already earned or accrued when assigned.

In the present case the community was the earner and owner of the legal fees in question, which had been earned and had accrued prior to the property settlement. Each spouse, like a partner, owned one-half of said earnings as a member of the marital community. (*Poe v. Seaborn,* 282 U. S. 101, 51 S. Ct. 58; *U. S. v. Goodyear* (C. C. A. 9), 99 Fed. (2d) 522.) While appellant's wife could and did transfer her one-half interest in said legal fees to appellant, such transfer could in no way affect her liability for income tax thereon which attached to said earnings the moment they were earned. *(Van Meter* and *Eubank* cases, *infra.)*

I.

The Right of Spouses in California to Agree That the Future Earnings of a Particular Spouse Shall Be His or Her Separate Property Is Only a Right of Emancipation.

Such cases as *Helvering v. Hickman,* 70 Fed. (2d) 985; *Harold G. Ferguson,* 34 B. T. A. 532; *George J. Somerville v. Commissioner,* 43 B. T. A. 968, and *Dale Van Every* (C. C. A. 9, Jan. 5, 1940), 108 Fed. (2d) 650 (certiorari denied April 22, 1940, 60 S. Ct. 891), are not in point because they involve earnings of a husband both earned and collected after the date of a property settlement, or in other words "future earnings." Furthermore, they do not involve the transfer or assignment of such "future earnings" but only the principle of *emancipation.*

These cases only stand for the proposition that by agreement either spouse in California may so *emancipate* the other spouse that his or her *future earnings* become not only the separate property of, but taxable to, the particular spouse emancipated. The particular spouse earning the income would then be taxable on his or her entire future earnings because such spouse would own the right to such earnings at the very time they were earned. This is exactly the same principle involved in the emancipation of a married woman by her husband in a separate property state or of a minor child by a parent and goes no further in its effect.

Kaltshmidt v. Weber, 79 Pac. 272, is sometimes cited as authority for the principle that the parties to a marital community may agree that *past* as well as *future* earnings shall be separate property and that the effect of such an agreement will be to convert such earnings from the status

of community property to that of separate property of the wife. It would appear from an examination of the *Kaltshmidt* case that only "future earnings" and not "past earnings" were there involved, but in any event the fact that a spouse may assign his or her half of certain income to the other spouse does not establish the principle that the assignor is thus relieved from income tax thereon.

The *Kaltshmidt* case, *supra,* was decided on the authority of *Wren v. Wren,* 100 Cal. 276, 34 Pac. 775. The *Wren* case, *supra,* was in turn decided upon the authority of *Riley v. Mitchell,* 36 Minn. 3, 29 N. W. Rep. 586. The *Riley* case involved a situation where a husband in Minnesota, a separate property state, emancipated his wife and agreed with her that her earnings should be her own property and not the property of the husband. At common law the wife's earnings belong to the husband and the Court held that by agreement he could make them hers—or emancipate her.

Obviously then this right of emancipation in California is only a right to release a spouse of his obligation to earn money for the marital community. This emancipation could only effect future earnings from the date thereof *for income tax purposes.* A child's earnings prior to emancipation would belong to the parent. A wife's earnings at common law prior to emancipation would belong to the husband. Likewise in a community property state the earnings of both spouses prior to emancipation belong to the marital community. *(Poe v. Seaborn, Goodyear* case, *supra.)*

Such emancipation would not apply to past earnings because such earnings would already be property and belong to the marital community. As property past earnings

can be transferred by agreement in the form of a gift, sale or other transaction, but such a transfer could not affect the liability of the transferor spouse to pay income tax on his or her community one-half thereof.

Unless this is the correct construction a husband and wife in California can agree that both the past and future earnings of the husband shall be the separate property of the wife and thus make all the past and future earnings of the husband taxable to the wife. Let us take the case of a husband who has a large separate estate and has a large income other than his salary, whereas his wife has no income other than her half interest in his salary. By agreement the husband then could make his past and future salary earnings her separate property and she would be taxable on the entire amount thereof. Obviously this is not the correct law, and while the husband has the right to transfer his community half of his past or future earnings to her, he cannot thus escape tax thereon.

This is so as to future earnings because in agreeing that his community half of his salary is the separate property of the wife, neither the husband nor the wife are emancipated. An emancipation requires the person emancipated to be the one who earns the income. As to his community half of his past earnings his income tax liability would attach the minute the income was earned and no subsequent act of his could relieve him from such tax. While such an agreement by the husband to make his salary the separate property of the wife would be effective as between the spouses, and such past or future earnings would be the separate property of the wife when earned by the husband, nevertheless he would still be taxable on

his community one-half of both his past and future earnings.

Likewise a husband in a separate property state can make at least his past earnings, and probably his future earnings, the separate property of his wife. *(Horst, Eubank, Schaffner* and *Van Meter* cases, *infra.)* For instance, let us take the case where a husband in either a separate or community property state assigns half of his future earnings to his wife in a property settlement agreement as alimony or in lieu of alimony. There would thus be a valid consideration for the assignment and such earnings would certainly be the separate property of the wife, but the husband could not successfully contend that, because one-half of his earnings was the separate property of the wife when collected, he is only taxable on half of his earnings.

In the case of *F. Eldred Boland,* 41 B. T. A. 930, a California husband attempted to assign 25% of his future earnings to his wife in a property settlement, but the Board of Tax Appeals rightly held that he was still taxable on the portion assigned to his wife. The Board held the marital community was terminated by the agreement. Therefore, the husband was in the same position as a husband in a separate property state. While the assignment of his earnings was perfectly good between the parties the Board held it did not relieve him from tax on the portion of his earnings assigned to the wife. The *Boland* case is therefore authority for the proposition that although a husband and wife can agree between themselves as to whose separate property the earnings of either may be, nevertheless this in no way determines who is to pay the tax on such assigned earnings. The taxability is de-

termined without reference to the assignment. In the *Boland* case there was unquestionably a consideration for the assignment which, under the rule applied by the lower court in this case, would make the wife taxable on the earnings assigned to her; there was as much a "division" of property in the *Boland* case as in the present case; there certainly was no gift or sale involved in that case; and the agreement unquestionably was valid as between the spouses.

The Board in the *Crosby* case, *infra,* cites the *Boland* case as authority for the proposition that a wife can assign to a husband her half interest in his past earnings and thus escape tax thereon. That point was not raised or considered in the *Boland* case. The property settlement agreement in the *Boland* case was made in 1929 and the earliest year involved was 1934. Furthermore, while Boland was a lawyer, he was only an employee and not a member of the law partnership concerned, so that it would seem incredible that the firm in 1934 still owed him salary earned in 1929 or prior thereto.

Actually in the *Boland* case the husband received the same benefit as if he had collected 100% of his income and turned 25% over to his wife as alimony. Thus he received the full economic benefit of 100% of his income. He constructively received his wife's 25% and paid it on his alimony obligation.

In the present case appellant's wife received the same benefit as if she had collected her half interest in said fee accounts receivable because she received from appellant his half of other property of equal value. Therefore, she too constructively received her one-half of said earned income and is taxable thereon.

II.

The Property Settlement Should Be Viewed Exactly the Same as if It Were an Agreement Between Two Unmarried People Who Owned Common Property.

The right which a husband and wife have in California to contract with each other is no strange or extraordinary right. Under the old common law the rights of a husband and wife to contract with each other with reference to their property were greatly restricted. Sections 158 and 159 of the California Civil Code merely remove these restrictions. The pertinent portion of Section 158 of the California Civil Code is as follows:

> "Either husband or wife may enter into any engagement or transaction with the other * * * respecting property *which either* might if unmarried." (Italics supplied.)

The property settlement transaction should be considered simply as an agreement whereby two individuals, who own common property, each transfer to the other his or her one-half interest in certain property in consideration for a reciprocal transfer of an undivided interest in certain other property. If this is kept in mind the transaction should and will not be confused by the husband and wife relationship, inasmuch as each spouse is only making the same contract "which either might if unmarried."

III.

Taxation Is a Practical Matter and a Taxpayer Is Taxable to the Extent, and Only to the Extent, That He or She Has Actually Been Enriched by a Particular Transaction.

As stated by the Court in *First Seattle D. H. National Bank v. Commissioner,* 77 Fed. (2d) 45:

> "Moreover, in view of the principle that, *in applying income tax laws, the substance, and not the form, of the transaction should control,* the exchange and sale of stock which was required under the whole contract herein should be treated as a single, composite transaction for income tax purposes, regardless of the formalities followed. See S. A. MacQueen Co. v. Com'r, 67 F. (2d) 857, 858 (C. C. A. 3); Tulsa Tribune Co. v. Com'r, 58 F. (2d) 937, 940 (C. C. A. 10); Western Maryland Ry. Co. v. Com'r, 33 F. (2d) 695 (C. C. A. 4); United States v. Phellis, 257 U. S. 156, 158, 42 S. Ct. 63, 66 L. Ed. 180; Weiss v. Stearn, 265 U. S. 242, 254, 44 S. Ct. 490, 68 L. Ed. 1001, 33 A. L. R. 520. In dealing with a situation not unlike the one at bar, the court, in the case of West Texas Refining Co. v. Com'r, 68 F. (2d) 77, 80 (C. C. A. 10), quoting from Prairie Oil & Gas Co. v. Motter, 66 F. (2d) 309, 311 (C. C. A. 10), said: *'If a taxpayer sought to avoid a tax on the profits of such a sale as this by asking the Commissioner to ignore the actualities, he would shortly and properly be reminded that taxation is an intensely practical matter and that the substance of the thing done, and not the form it took, must govern.'*" (Italics supplied.)

In the present case the substance of the transaction is that appellant's wife transferred her half interest in the

fee accounts receivable and other assets to appellant and he in return transferred to her his half interest in other property and assumed and paid her 1934 and 1935 income taxes. To say that she realized no "gain" on this transaction is to ignore the actualities of the transaction. Likewise to say that appellant realized a "gain" or profit equal to the full amount collected by him from her half of said accounts ignores the fact that he transferred property to her, which added to her taxes assumed and paid by him equalled the face value of her half of said accounts. In effect appellant purchased his wife's one-half interest in said fee accounts receivable. By collecting such income he disposed thereof and his gain will be the excess, if any, of the amount received over his purchase price thereof.

IV.

Appellant Could not Have Received Income of More Than $2,377.57 by Acquiring and Collecting the $26,014.23 of Fee Accounts Receivable.

In the property settlement appellant transferred or gave up to his wife his one-half interest, costing $38,610.41, in certain joint and community property. [R. 59.] He had already paid an income tax on this $38,610.41. [R. 59.] He also assumed and paid his wife's 1934 income tax of $5,082.78 and her 1935 income tax of $3,118.95, or a total transferred to or paid for his wife in the sum of $46,812.14. [R. 59.]

In consideration for these acts by appellant, he received his wife's one-half interest, having a market value of $23,175.48, in certain other joint and community property, and her one-half interest, amounting to $26,014.23, in

said fee accounts receivable, or a total of $49,189.71. [R. 58.]

The Government contends that appellant is taxable on the sum of $26,014.23, which is the amount of his wife's one-half interest in the accounts receivable which were collected after the property settlement. However, since income tax is payable only on net income, appellant could not possibly be taxable on this amount, since his net income would be the difference between the amount he transferred to his wife, on which he had already paid an income tax ($38,610.41), and the net amount received in the property settlement ($40,987.98), or $2,377.57, arrived at as follows:

Market value of one-half interest in accounts receivable received from wife	$26,014.23
Market value of one-half interest in other property received from wife	23,175.48
	$49,189.71
Less 1934 and 1935 income taxes paid for wife	8,201.73
Amount received by appellant	$40,987.98
Less his cost of property transferred to wife on which he has already paid income tax	38,610.41
Actual net income "realized" by appellant	$ 2,377.57

The Government claims appellant realized income of $26,014.23 when he collected the one-half of the accounts receivable acquired from his wife. This cannot be correct because he has already paid income tax on $38,610.41 (the

cash used to buy his one-half interest in the property transferred to his wife) and if he is taxed on $26,014.23 more he will have paid an income tax on income of $64,624.64 and he only received $40,987.98. Since he has made no gift to his wife such a result is unreal and ignores the actualities of the transaction.

V.

Appellant's Wife Actually "Realized" Net Income of $17,289.20 in the Property Settlement.

Appellant's wife received appellant's half interest, having a market value of $37,000.00, in certain property and had debts paid for her in the sum of $8,201.73, a total of $45,201.73 received from appellant in the property settlement. [R. 59.] She gave up her half of the fee accounts receivable on which she had no cost, and gave up to him her half of other property on which she had a cost of $27,309.53 and on which she had already paid an income tax. [R. 59, 60.] Accordingly she received or "realized" net income of $17,892.20 computed as follows:

Market value of one-half interest in property received from appellant	$37,000.00
1934 and 1935 income taxes paid by appellant	8,201.73
Total market value of settlement received by wife	$45,201.73
Less cost of property transferred to appellant (on which tax has already been paid	27,309.52
Net income received by wife on which she had paid no income tax	$17,892.20

The Government claims appellant's wife realized no income by the property settlement. This cannot be right because she has only paid an income tax on $27,892.20 (the cost of her half interest in the property transferred to her husband) and she received $45,201.73. She was actually enriched by the difference of $17,892.20 and therefore "realized" net income of $17,892.20. Since appellant did not make a gift to her it would ignore the actualities of the transaction to say she realized no income.

If she has no taxable income by reason of the property settlement agreement, when, if at all, does she pay an income tax on this $17,892.20? If she is taxable on this $17,892.20 when she sells the one-half interest in the properties acquired from appellant and appellant is taxable on the $26,014.23, then the Government will receive a tax on income of $43,906.43 whereas the total income involved could only be $26,014.23. If she never pays an income tax on this $17,892.20 then she had paid a tax on only $27,309.53 and yet has received $45,201.73. In some unreal and technical manner she has acquired $17,892.20 on which she will never pay an income tax and yet no gift was involved.

Had this excess of $17,892.20 been received by her as alimony or for the release of any other marital right the contention might logically be made that she is not taxable thereon, but it is indisputable that she received the same as her share of the joint and community property. Actually she received slightly less than appellant although every effort was made to make an exactly equal division.

This court must decide whether, because of certain claimed legal technicalities or distinctions, which are more illusory than real, appellant must pay an income tax on a fictitious income of $26,014.23 and his wife is not taxable on any income or profit, or whether the actual result of the transaction is to be followed and that appellant is taxable on income in the amount of $2377.57 and his wife is taxable on income in the amount of $17,892.20.

VI.

Appellant's Wife Is Taxable on Her One-half of the Income Earned but Not Collected Prior to the Property Settlement Unless She Thereby Sold Her Half Interest to Appellant, in Which Event She Is Taxable on the Consideration Received.

Appellant's wife owned one-half of the earned but uncollected income under consideration, prior to the property settlement. (*Poe v. Seaborn, supra; U. S. v. Goodyear, supra; King v. Commissioner*, 26 B. T. A. 1158, affirmed 5th Circuit, 69 Fed. (2d) 639, 13 A. F. T. R. 747; *Albert Houston v. Commissioner of Internal Revenue*, 31 B. T. A. 188; *Delvin v. Commissioner*, 9th Circuit, 82 Fed. (2d) 731, 17 A. F. T. R. 690; *Asher v. Welch* (D. C. Cal.), 28 Fed. Sup. 893, 23 A. F. T. R. 664, affirmed 111 Fed. (2d) 59.) As the Court said in *Poe v. Seaborn, supra:*

> "The earnings (of the husband) are never the property of the husband, but that of the community." (Parenthetical clause supplied.)

There can be no doubt that she would have been taxable on her half of said earned but uncollected income

when it was collected had there been no separation agreement. (*U. S. v. Malcolm,* 282 U. S. 792, 51 S. Ct. 184, 9 A. F. T. R. 956; *Poe v. Seaborn, supra.*) On the accrual basis of accounting she would have been taxable the minute the fees in question were earned or accrued. Therefore, if appellant is to be held taxable on her half of such earned but uncollected income the wife must, in some manner, have escaped income tax thereon because the same income cannot be taxable to both.

It will now be shown that appellant's wife cannot escape paying income tax either on her half of said earned but uncollected income, or on the consideration which she received in lieu thereof, and therefore appellant is not taxable on her said half.

(a) Once a Person Becomes the Owner of Earned or Accrued Income There Is No Possible Way in Which He Can Avoid Ultimately Paying Income Tax Thereon.

If a cash basis taxpayer gives such income away he is still taxable on it when collected and the donee is not. (*Helvering v. Horst,* 311 U. S. 112, 61 S. Ct. 144; *Helvering v. Eubank,* 311 U. S. 122, 61 S. Ct. 149; *Harrison v. Schaffner,* 312 U. S. 579, 61 S. Ct. 759.

The *Horst, Eubank* and *Schaffner* cases, while involving gifts of income, when carefully analyzed, clearly stand for the broad general principle that *no owner of accrued but uncollected income can transfer the same by any conceivable device and relieve himself or herself from paying the income tax thereon.*

The Supreme Court in the *Schaffner* case, *supra,* referring to its previous decisions in the *Horst* and *Eubank* cases, set forth this principle in the following language:

> "Since granting certiorari we have held following the reasoning of Lucas v. Earl, *supra,* that one who is entitled to receive at a future date, interest or *compensation for services* and who makes a gift of it by an anticipatory assignment, *realizes taxable income quite as much as if he had collected the income and paid it over to the object of his bounty.* Helvering v. Horst, 311 U. S. 112, 61 S. Ct. 144, 85 L. Ed. ....., 131 A. L. R. 655; Helvering v. Eubank, 311 U. S. 122, 61 S. Ct. 149, L. Ed. .... Decision in these cases was rested on the principle that the power to dispose of income is the equivalent of ownership of it and that the exercise of the power to procure its payment to another, *whether to pay a debt or to make a gift,* is within the reach of the statute taxing income 'from any sources whatever.'" (Italics supplied.)

Fairly construed this means that whenever an owner of earned or accrued income exercises "the power to procure its payment to another" whether for or without consideration, the income is taxable to the owner of the income who disposes of it. It is difficult to see how there could be a clearer expression of this general principle. It is even more difficult to see how when appellant's wife has exercised her power to procure the payment of her half of certain earned income to appellant and

has received in lieu thereof his half of certain other property, she can be said to have realized no income from the transaction.

If a cash basis taxpayer dies he must pay an income tax on all earned or accrued but uncollected income in his last income tax return. (Sec. 42, Rev. Act of 1934; *Helvering v. Enright,* 312 U. S. 636, 61 S. Ct. 777; *Pfaff v. Commissioner,* 312 U. S. 646, 61 S. Ct. 783.) Under the principle of these two Supreme Court cases clearly appellant's wife would have been taxable on her half of said fees had the community been terminated by death instead of by the property settlement agreement.

If a cash basis taxpayer receives cash from a third person in lieu of such accrued or earned income he is taxed on "the commuted payment" which "replaced the future income with cash." (*Helvering v. Smith,* 90 Fed. (2d) 590.)

Here appellant's wife "replaced the future income with" other property instead of "cash" and she should be taxed on the market value of such property. In fact unless this is the correct rule a cash basis taxpayer can easily avoid income tax by simply trading income earned or accrued but not collected for other property. Of course the correct rule is that such a taxpayer is taxable on the market value of the property which replaces the future income and there is no loophole.

(b) When a Cash Basis Taxpayer Does Not Actually Collect Accrued Income but Makes Some Other Disposition Thereof a "Taxable Event" Occurs Which Makes Him Taxable Immediately on the Uncollected Income.

In the case of a taxpayer reporting on the cash receipt and disbursement basis commonly known as the "cash basis" two things must happen before he receives taxable income, viz.: First, the income must have been earned or accrued in the case of ordinary income and the capital increment must have occurred in the case of capital gain, and, second, there must be a "taxable event" whereby the earned or accrued income or the capital increment is realized by the owner thereof.

On the accrual basis only the first thing must occur, viz., the income must have been earned, or accrued whereupon the owner of the income is immediately taxable thereon. In this case, had appellant and his wife been reporting their income on the "accrual" instead of the "cash" basis, each would have been taxable on one-half of said fees prior to the property settlement because the fees were earned or accrued prior thereto.

This "taxable event" is called the "final event of enjoyment" in the *Horst* case, *supra*, where the Court said as follows:

> "In the ordinary case the taxpayer who acquires the right to receive income is taxed when he receives it, regardless of the time when his right to receive payment accrued. *But the rule that income is not*

taxable until realized has never been taken to mean that the taxpayer, even on the cash receipts basis, who has fully enjoyed the benefit of the economic gain represented by his right to receive income, can escape taxation because he has not himself received payment of it from his obligor. The rule, founded on administrative convenience, is only one of postponement of the tax to the *final event of enjoyment* of the income, usually the receipt of it by the taxpayer, and not one of exemption from taxation where the enjoyment is consummated by some event other than the taxpayer's personal receipt of *money or property.* Cf. Aluminum Castings Co. v. Routzahn, 282 U. S. 92, 98. *This may occur when he has made such use or disposition of his power to receive or control the income as to procure in its place other satisfactions which are of economic worth.* The question here is, whether because one who in fact receives payment for services or interest payments is taxable only on his receipts of the payments, he can escape all tax by giving away his right to income in advance of payment. If the taxpayer procures payment directly to his creditors of the items of interest or earnings due him, see Old Colony Trust Co. v. Commissioner, *supra*; Bowers v. Kirby Lumber Co., 284 U. S. 1, or if he sets up a revocable trust with income payable to the objects of his bounty, §§166, 167 Revenue Act of 1934, Corliss v. Bowers, *supra;* cf. Dickey v. Burnet, 56 F. (2d) 917, 921, he does not escape taxation because he did not actually receive the money. Cf. Douglas v. Willcuts, 296 U. S. 1; Helvering v. Clifford, 309 U. S. 331 (23 A. F. T. R. 1077).

"Underlying the reasoning in these cases is the thought that income is 'realized' by the assignor because he who owns or controls the source of the

income also controls the disposition of that which he could have received himself and diverts the payment from himself to others as the means of procuring the satisfaction of his wants. *The taxpayer has equally enjoyed the fruits of his labor or investment and obtained the satisfaction of his desires whether he collects and uses the income to procure those satisfactions, or whether he disposes of his right to collect it as the means of procuring them.* Cf. Burnet v. Wells, *supra.*" (Italics supplied.)

It will be noted that the Supreme Court indicates above that where "the enjoyment" (of income) "is consummated by" "the taxpayer's personal receipt of money or property" such taxpayer is clearly taxable on the income enjoyed. Here appellant's wife enjoyed her half of said fee accounts receivable by receiving "property" from appellant in lieu thereof and she should be taxed on her half of said fees the same as if she had collected them.

Such a taxable event takes place when a property settlement is made and a husband transfers corporation stock, on which an unrealized increment has occurred, to his wife in consideration of her release or transfer of her interest in other property and in satisfaction of his obligation to support her. (*Commissioner v. Mesta*, decided by the United States Circuit Court of Appeals, Third Circuit, on November 25, 1941, reversing 42 B. T. A. 933).

Such a taxable event occurs in the case of a gift. (*Horst* and *Eubank* cases, 311 U. S. 112, 61 S. Ct. 144; 311 U. S. 122, 61 S. Ct. 149.)

The most common taxable event where a cash basis taxpayer realizes taxable ordinary income, although he does not collect the income himself, is where the payment of income is made directly to a creditor of the taxpayer. (*Old Colony Trust Co. v. Commissioner,* 279 U. S. 716, 49 S. Ct. 499; *Harrison v. Schaffner, supra.*)

Another type of taxable event is where a corporation retires its bonds at a lesser price than at which they were issued. (*U. S. v. Kirby Lumber Co.,* 284 U. S. 1, 52 S. Ct. 4.)

Another type of taxable event is where accrued earnings are transferred to another for cash; the "commuted payment" "replaced the future income with cash." (*Helvering v. Smith,* 90 F. (2d) 590 (C. C. A. 2); *Doyle v. Commissioner* (C. C. A. 4), 102 Fed. (2d) 86.)

Another instance of a taxable event which is not a technical sale or exchange is the case of *Helvering v. Elverson Corp.,* 122 Fed. (2d) 295 (1941) (C. C. A. 3), where the Court said:

> "Whenever anyone surrenders a thing of value for another thing of value, the surrender will for tax purposes ordinarily close the transaction by which he acquired the thing surrendered."

Certainly in this case appellant's wife surrendered things (her one-half of the earned but uncollected income) of value for other things of value and appellant did likewise. It is difficult to see why this reciprocal surrender of

things of value for other things of value is not a taxable event whereby gain or loss is immediately recognized. (Also see *Mesta* case, *supra.*)

Appellant assumed his wife's 1934 and 1935 income taxes as a part of the consideration for the transfer to him by her of her one-half interest in said earned but uncollected income. Her obligations were thus satisfied just the same as the husband's obligation was satisfied in the *Mesta* case, *supra.* This fact alone would make her taxable on her half of said earned income.

(c) Appellant Is Not Taxable on Any Part of the Wife's One-half of Said Fees Unless He Acquired Such Half for a Valuable Consideration, in Which Event He Is Only Taxable to the Extent, if Any, by Which the Collections Therefrom Exceed the Consideration Paid by Him to Her.

Since appellant's wife is taxable on her half of said fees unless she disposed of such half in a taxable transaction, conversely, appellant is not taxable upon any part of the collections thereof unless he acquired said half for a valuable consideration—in effect a purchase. Then he is taxable only upon the amount of $2,377.57 by which the collections exceeded the purchase price paid. If no sale, exchange or taxable disposition occurred the wife is still taxable upon her half of such collections.

VII.

The "Walz Case," Which Was Incorrectly Decided by the Board of Tax Appeals, Has Resulted in Incorrect Decisions by the Board in the "Mesta Case" and the "Crosby Case" and the Lower Court in This Case.

(a) The Walz Case.

At the time the lower court decided this case, only two cases were cited by the appellee as authority for the proposition that no gain or loss is recognized to either spouse in a property settlement, viz., *Walz v. Commissioner,* 32 B. T. A. 718, decided in 1935, and not appealed, and *Mesta v. Commissioner,* 42 B. T. A. 933, decided on October 10, 1940, and appealed to the United States Circuit Court of Appeals, Third Circuit, which handed down its opinion reversing the Board on November 25, 1941 too late to be considered by the lower court in deciding the present case.

Because of the reversal of the Board in the *Mesta* case by said Third Circuit Court, the *Walz* and *Mesta* cases, *supra,* no longer support the theory that no gain or loss is recognized to either spouse when a property settlement is made between them. On the contrary, the *Mesta* case is now authority for the proposition that gain or loss is recognized to the spouse who actually has a gain or loss in the transaction. Appellant believes that the lower court would have reached a different conclusion in this case had it had the benefit of the Third Circuit Court's decision in said *Mesta* case.

In the *Walz* case, *supra,* a husband in a property settlement transferred his community half interest in corporation stock to his wife and in addition agreed to pay her a

certain sum of money. In return the wife gave up her half of all other community property to the husband. The corporation stock at the date of settlement was worth less than the community cost thereof and the husband claimed a loss on 100% of the difference between cost and market. The Board held no gain or loss occurred because there was a "division" not "sale" or "exchange" involved.

A careful analysis of this case, which was not reviewed by the Board as a whole or appealed, shows that both the Division deciding the case and the taxpayer were wrong. Since the taxpayer husband only transferred his community one-half of the stock to his wife (she already owned one-half thereof) his loss was only one-half of that claimed by him. But Walz did sustain a loss of one-half of the claimed amount because he "disposed" of his half and received in return his wife's half of other property. *(Mesta* case, *supra* and *infra.)* He surrendered a thing of value for another thing of value, which closed the transaction by which he acquired his half of the stock, and gain or loss then occurred. *(Helvering v. Elverson Corp., supra.)*

(b) The Mesta Case.

In the *Mesta* case, a Division of the Board again held that a property settlement between husband and wife was a division of property and that neither realized gain or loss by such transaction.

In that case the husband in a property settlement transferred certain corporation stock and some other miscellaneous separate property to his wife, and she gave up to him her interest in the home which was owned by her and Mesta as tenants by the entirety; each spouse released any claim they might have to the property of the other; and

she acknowledged that the delivery of the securities and property mentioned above was "in full settlement of all claims and demands for her maintenance and support."

The corporation stock in question had a cost of $7,574.56 and a market value of $156,975.00 at the time of settlement. The Commissioner claimed that Mesta had gain, profit or income of $149,440.44 by the transaction. Mesta claimed he had no gain by the transaction.

The Board held that Mesta realized no gain, profit or income, because there was

> "Merely a property settlement between a man and his estranged wife—in other words a division of property."

The Board, in deciding the *Mesta* case, probably relied upon the *Walz* case, *supra,* but in any event the principle of the two decisions was the same, viz., that no gain or loss occurs in a property settlement because it is a division of property.

The *Mesta* case, unlike the *Walz* case, was appealed and on November 25, 1941, the United States Circuit Court of Appeals for the Third Circuit handed down its opinion reversing the Board and said in part as follows:

> "Had the stock not been transferred he would not have achieved a taxable gain because the economic gain would have been unrealized. *The disposition of the stock was the taxable event in the case at bar.* This is so even though Mesta may not have received payment in money or property from Mrs. Mesta. The point which we are trying to make is clearly established by the decision of the Supreme Court in Helvering v. Horst, 311 U. S. 112, wherein Mr. Justice Stone said: 'Admittedly not all economic gain

of the taxpayer is taxable income. From the beginning the revenue laws have been interpreted as defining "realization" of income as the taxable event, rather than the acquisition of the right to receive it. And "realization" is not deemed to occur until the income is paid. But the decisions and regulations have consistently recognized that receipt in cash or property is not the only characteristic of realization of income to a taxpayer on the cash receipts basis. *Where the taxpayer does not receive payment of income in money or property realization may occur when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him.'* The case cited involved *a transfer of income* and not a transfer of *income-producing property* but it supplies an illuminating analogy.

"The Board of Tax Appeals concluded that there was no way to measure the amount or value received by Mesta from the disposition of the stock. Section 22(a) of the Revenue Act of 1934, c. 277, 48 Stat. 680, provides that ' "Gross income" includes gains * * * from * * * sales, or *dealings in property,* whether real or personal * * *.' Section 22(a) states, 'In the case of a sale or *other disposition of property,* the gain or loss shall be computed as provided in Section 111.' Section 111(a) provides, 'The gain from the sale or *other disposition of property* shall be the excess of the amount realized therefrom * * *,' and subdivision (b) provides, 'The amount received from the sale or *other disposition of property* shall be the sum of any money received plus the fair market value of the property (other than money) received.' Section 112 provides, 'Upon the sale or exchange of property the entire amount of the gain or loss, determined under §111, shall be recognized * * *.'

"We think there can be no doubt that Congress intended a measurement of values under the circumstances indicated by the statutes quoted, notwithstanding difficulties in determining those values. *In the case at bar there is a gain in the value of the stock and an event whereby that gain was realized.* * * *" (Italics supplied.)

The Circuit Court reiterated the familiar principle heretofore set forth in this brief, that the *disposition,* regardless of the manner thereof, of earned or accrued income or of unrealized capital increment results in a "taxable event" which causes the unrealized income or increment to become realized. The Court rejected the theory that because a property settlement agreement is a division of property no "taxable event" occurs and no gain or loss is realized. The appellate court's reversal of the *Mesta* case was in principle also a reversal of the *Walz* case and the *Crosby* case, *infra,* and the lower court's opinion in this case.

(c) The Crosby Case.

Crosby v. Commissioner, 46 B. T. A.........., was decided on February 18, 1942. In that case the taxpayer had transferred a small amount of property to his wife and had agreed to pay her monthly cash payments which were styled "alimony," in the written property settlement agreement, but which he claimed were payment for her community half interest in certain earned but uncollected commissions. The Board held that the payments were "alimony" and not payment for the wife's one-half of the commissions; that, on the authority of the lower court's opinion in the present case, no gain could have occurred to the wife when she assigned her interest in such commis-

sions to her husband because there was merely a division of property; and finally that even if he were entitled to recover the cost of property which he had transferred to his wife he had not established the "cost" or "basis" thereof.

An appeal has been taken in the *Crosby* case and such appeal will ultimately come before this Court. The Board in the *Crosby* case made no mention of the reversal of the *Mesta* case, *supra,* by the Third Circuit Court, probably because it was not called to its attention, having been decided after the submission of the *Crosby* case.

VII.

The Lower Court's Decision Is in Direct Conflict With Horst, Eubank and Schaffner Cases.

The decision by the lower court in this case is exactly the same in principle as the *dissenting opinion* of Justice McReynolds in the *Eubank* case, *supra,* in which he cited with approval the following language from the Circuit Court's decision which was reversed by the Supreme Court in said case:

> "'* * * *But when a taxpayer who makes his income tax return on a cash basis assigns a right to money payable in the future for work already performed, we believe that he transfers a property right, and the money, when received by the assignee, is not income taxable to the assignor.*'" (Italics supplied.)

Justice McReynolds said further in his *dissenting opinion:*

> "A mere right to collect future payments, for services already performed, is not presently taxable as 'income derived' from such services. It is property which may be assigned. *Whatever the assignor re-*

> *ceives as consideration may be his income;* but the statute does not undertake to impose liability upon him because of payments to another under a contract which he had transferred in good faith, under circumstances like those here disclosed." (Italics supplied.)

The Government's contention in the present case, which was approved by the lower court, is exactly the same as the principle which was rejected by the Supreme Court in the *Eubank* and *Horst* cases, *supra.*

The lower court in this case casually waived aside the *Horst* and *Eubank* cases, *supra,* with the statement that no gift is involved herein but in the *Schaffner* case, *supra,* the Supreme Court did not so restrict such decisions when it said:

> "Decision in these cases (Horst and Eubank) was rested on the principle that the power to dispose of income is the equivalent of ownership of it and that the exercise of the power to produce its payment to another, *either to pay a debt or to make a gift,* is within the reach of the statute taxing income 'from any source whatever.' " (Italics and parentheses supplied.)

This language establishes the broad general principle that no owner of earned but uncollected income can transfer the same by any conceivable device and relieve himself or herself from paying the income tax thereon. Fairly construed, this language means that whenever an owner of earned or accrued income exercises "the power to procure its payment to another," either for or without consideration, the assignor or transferor is held still taxable

on the income itself when collected, if no valuable consideration is involved, or is taxable on the consideration received in lieu of said income, if the transfer is one for valuable consideration. But in neither event is the assignee or transferee taxable thereon, except that an assignee for valuable consideration is taxable on any excess of the amount collected over the amount or value of the consideration transferred.

A correct statement of applicable law is contained in the case of *Van Meter v. Commissioner* (C. C. A. 8), 61 Fed. (2d) 817, 11 A. F. T. R. 1002, cited with approval by the Board in *Horst v. Commissioner,* 39 B. T. A. 757, at page 760, as follows:

> "* * * It may be true that income already earned is transferable as a species of property, but that has no effect upon the power and intention of Congress to tax income to the earner. The earner may, in a legally binding way, dispose of his earnings, whether they are already earned or are to be earned, without affecting in the slightest manner his status as earner thereof and his resulting liability for taxation thereon as income."

In the *Van Meter* case the Court held that an insurance agency corporation and not its stockholders was taxable on renewal commissions assigned to such stockholders, who did not own them when earned but did own them at the time collected. There may have been and probably was a legal consideration for the assignment, but there was no cash or property received and returned as income by the corporation in lieu of the commissions. The same type of

renewal commissions were involved in the *Van Meter* case as in the *Eubank* case, *supra.* Such renewal commissions are the same in principle as the income involved in this case.

Perhaps a clearer restatement of the principle announced in the *Horst* and *Van Meter* cases, *supra,* would be as follows:

> Ownership at the time income is earned or accrued determines the person who is taxable thereon, and ownership at the time of collection is immaterial.

The position of the Commissioner in this case which was affirmed by the lower court is in effect as follows:

> Ownership at the time income is collected determines the person who is taxable thereon, and ownership at the time said income was earned or accrued is immaterial.

The lower court may have been confused in this case by the fact that the husband (appellant) performed the actual services for which the legal fees were paid. However, the community was the "earner" not appellant and prior to the property settlement, he was never the owner of more than his half of such earnings, which he owned as a member of the marital community. As the U. S. Supreme Court said in the *Poe v. Seaborn* case, *supra:*

> "The earnings (of the husband) are never the property of the husband, but that of the community." (Parenthetical clause supplied.)

Also see *Goodyear* case, *supra.*

IX.

If the Property Settlement Was a "Tax-Free Exchange" Transaction on Which No Gain or Loss Is Recognized, Appellant Only Realized Income of $1,257.39 When He Collected His Wife's One-half of the Accounts Receivable, and His Wife Realized Either No Income at All or Income of $8,201.73.

Up to this point the brief has been devoted to demonstrating that appellant's wife realized income at the exact moment when she disposed of her half interest in said accounts receivable, representing legal fees earned but not collected, regardless of whether appellant ever collected said account, and that appellant realized income only to the extent of the difference between his cost of property transferred to his wife and the $26,014.23 collected from her half of said accounts. Now appellant will show, in the alternative, that even though his wife had no "taxable income" by the disposition of her half interest in said accounts, or in other words, even if the property settlement agreement was a transaction on which no gain or loss was recognized to either spouse, nevertheless, appellant under this theory only had "taxable income" to the extent of $1,257.39 and not $26,014.23 when he collected his wife's half interest in said accounts.

The income tax law provides for an exact determination of the amount of gain or loss on every transaction, but provides that in certain instances the actual gain or loss, although clearly "realized" shall not be "recognized" for income tax purposes. However, when any such gain is "realized" but not "recognized" the taxpayer is required to use the cost basis of the property transferred as the cost or basis of the property acquired. This in effect

defers the payment of income tax on the gain until the property acquired in the transaction is subsequently disposed of. Correctly interpreted this principle is all that the *Walz* case, *supra*, stands for as is shown by the following quotation therefrom:

> "Gain or loss on the property thus divided would depend upon its subsequent disposal by the parties."

Thus Section 111 of the Revenue Act of 1934 provides the method for determining the gain or loss "realized" from the sale or "other disposition of property" but provides that the gain or loss so determined shall only be recognized to the extent provided for in Section 112. Section 112 provides that the entire gain or loss shall be "recognized" except in the case of certain exchanges on which Congress thought that the gain or loss should be deferred for income tax purposes until the new property is disposed of. Section 113(a)(6) provides that in the case of certain "tax-free exchanges," since no gain or loss is recognized, the cost of the new property shall be the same as the cost of the old property for the future determination of the gain or loss when the new property is disposed of.

Assuming only for the purpose of argument that no gain or loss was recognized to either appellant or his wife by the property settlement transaction, and applying Sections 111, 112, and 113, *supra*, it is then apparent that appellant would be entitled to use, as his cost of the half of the accounts receivable and other property acquired from his wife the cost of his one-half interest in the property transferred to her, plus the amount of cash paid out by him for her, which would be $38,610.41 plus $8,201.73, or a total of $46,812.14. [R. 59.] Section 113(a)(6),

Revenue Act of 1934; *Wells Fargo Bank & Union Trust Co. v. McLaughlin,* 78 Fed. (2d) 934 (C. C. A. 9).

In addition to her interest in accounts receivable having a face and market value of $26,014.23, he received her interest in other property having a market value of $23,-175.48, making a total of $49,189.71 received from his wife. [R. 58.] Therefore, his cost or basis of her half of the accounts receivable would be $\frac{\$26,014.23}{\$49,189.71}$ of $46,-812.14 or $24,756.84.

When he collected his wife's one-half interest in the accounts receivable he received $26,014.23. Deducting his cost of $24,756.84 from $26,014.23 would then give him a "recognized" income or profit of $1,257.39 from such collections.

This compares with the profit of $2,377.57 which has already been demonstrated that appellant actually "realized" out of the transaction. The "realized" but not "recognized" difference of $1,120.18 ($2,377.57 minus $1,257.39) would not be "recognized" until appellant disposed of the remaining property which he received from his wife. Appellant's cost of the remaining property would be $\frac{\$23,175.48}{\$49,189.71}$ of $46,812.14 or $22,055.30; the market value of the other property received from his wife was $23,175.48, making a difference of $1,120.18, which would represent profit actually "realized" by him but not "recognized" for income tax purposes until he disposed of such remaining property.

Under the "tax-free exchange" theory, appellant's wife received his half interest, having a market value of $37,-

000.00, in certain property and received cash payments for her benefit of $8,201.73, or a total of $45,201.73. [R. 59.]

Her cost of the half interest in property passing from her to appellant was $27,309.52, representing no cost for her half interest in the accounts receivable and a cost of $27,309.53 for her interest in other property. [R. 59, 60.] Therefore, she actually "realized" a profit of $17,-892.20 on the transaction as demonstrated in the first part of the brief. However, either no part of this profit would be "recognized" for income tax purposes until she disposes of the half interest in the property received from her husband; or, in the alternative, not more than $8,-201.73 would be "recognized," being the amount of her tax liability assumed and paid by appellant. This debt assumption of $8,201.73 might be treated as "other property or money" which is the exception (Sec. 112(c) of the Revenue Act of 1934) to the general rule that no gain is recognized from certain tax-free exchanges. In any event under this theory appellant's wife would be taxable on a maximum of $8,201.73 and the balance of the "realized" profit of $17,892.20 would not be "recognized" until she disposed of the one-half interest in other property received from appellant.

Thus even if the property settlement transaction were one on which no gain or loss is "recognized" to either spouse, the correct application of the income tax laws would result in both spouses "realizing" exactly the same gain as if gain or loss were "recognized" on the transaction. but only a portion of the income actually "realized" would be "recognized" until the spouses disposed of the remaining property interests received by them in the property settlement.

8. Conclusion.

Upon consideration of the foregoing it is submitted that appellant either received no taxable income when he collected the half of said fees acquired from his wife in the property settlement or in the alternative he received income not in excess of $2,377.57 when he collected said half. The decision of the District Court is erroneous and should be reversed.

Respectfully submitted,

TODD W. JOHNSON,
In Propria Persona.

argued by Mr. Horner.